STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	)	
Proposed General Increase in	)	Docket No. 14-0224
Rates for Gas Delivery Service	)	
	)	
THE PEOPLES GAS LIGHT AND COKE COMPANY	)	
Proposed General Increase in	)	Docket No. 14-0225
Rates for Gas Delivery Service	)	(cons.)

REBUTTAL TESTIMONY OF DAVID J. EFFRON

ON BEHALF OF
THE PEOPLE OF THE STATE OF ILLINOIS

September 3, 2014

AG EXHIBIT 7.0

ILLINOIS COMMERCE COMMISSION
DOCKET NOS. 14-0224/0225 (cons.)
REBUTTAL TESTIMONY OF DAVID J. EFFRON

TABLE OF CONTENTS

EXHIBIT LIST

I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is David J. Effron. My business address is 12 Pond Path, North Hampton, New Hampshire, 03862.

Q. Have you previously submitted testimony in this docket?

A. Yes. I submitted direct testimony on July 2, 2014, marked as AG Exhibit 1.0. My qualifications and experience are included with my direct testimony.

II. INTRODUCTION AND SUMMARY OF TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. In this rebuttal testimony, I respond to the rebuttal testimony of North Shore Gas Company ("North Shore" or "NS") and The Peoples Gas Light and Coke Company ("Peoples Gas" or "PGL") witnesses, Derricks, Moy, Hengtgen, Lazzaro, Cleary, Stabile, Hans, Kupsh, Egelhoff, and Kinzle. (Collectively, North Shore and Peoples Gas are referred to as the "Companies.") I also update certain of my proposed adjustments to rate base and operating expenses based on the receipt of later information since the preparation of my direct testimony and on my responses to the Company's rebuttal testimony, as contained herein.

III. REVENUE REQUIREMENT ISSUES

A. RATE BASE

1. Utility Plant

Q. Do the Companies agree with your proposal to reduce the 2014 AMRP additions to plant in service included in Peoples Gas' test year rate base in its direct testimony?

A. No. Mr. Lazzaro addresses this issue. He agrees that the 2014 AMRP plant additions included in Peoples Gas test year rate base should be reduced from the balance reflected in its direct case. NS-PGL Ex. 23.0 at 5:95-97. However, the reduction that he proposes in his rebuttal testimony is significantly less than the adjustment that I proposed in my direct testimony.

Q. Is the revised estimate of 2014 AMRP capital expenditures reflected by Peoples Gas in its test-year rate base reasonable?

A. No. In response to Data Request AG 18.03, Peoples Gas provided the actual AMRP plant expenditures in 2014 through July. The total AMRP plant expenditures for this seven-month period were $100,076,000, which equates to $14,297,000 per month. This translates into annual level of AMRP plant expenditures of $17,159,000. This compares to the Peoples Gas revised forecast of $237,436,000 of 2014 AMRP capital expenditures (response to Data Request AG 18.02).

Peoples Gas also provided actual expenditures for AMRP related cost of removal in response to Data Request AG 18.03. The actual expenditures for AMRP cost of removal for this seven month period were $9,988,000, which equates to $1,427,000 per month. This translates into an annual level of expenditures for cost of removal of $17,122,000. This compares to the Peoples Gas revised forecast of $34,353,000 of 2014 AMRP cost of removal (response to Data Request AG 18.02).

Q. Should the balance of 2014 AMRP capital expenditures included in the Peoples Gas test-year rate base be modified?

A. Yes. The forecasted 2014 expenditures for AMRP plant and cost of removal included in the test-year rate base should be reduced to a balance that is more consistent with the actual experience in 2014 to date. As I noted in my direct testimony, making such a reduction to the forecasted 2014 capital expenditures poses little risk to Peoples Gas. AG Ex. 1.0 at 8:179-9:184.

Q. What do you recommend?

A. As noted above, based on the experience in the first seven months of 2014, the annual 2014 AMRP plant additions will be $171,559,000. This is $65,877,000 less than the 2014 AMRP additions forecasted by Peoples Gas. I recommend that the 2014 AMRP plant additions included in the test-year rate base be reduced accordingly.

Similarly, based on the experience in the first seven months of 2014, the annual 2014 AMRP cost of removal will be $17,122,000. This is $17,231,000 less than the 2014 AMRP cost of removal forecasted by Peoples Gas. I recommend that the 2014 AMRP also be adjusted to reflect this difference.

Q. What is the effect of reducing the 2014 AMRP expenditures included in the 2015 test-year rate base?

A. The effect is to reduce the PGL 2015 test-year rate base by $72,843,000 (Schedule DJE PGL B-1), including the effect on accumulated deferred income taxes ("ADIT"). Further, the PGL 2015 test-year depreciation expense is reduced by $2,365,000.

Q. Did any other witnesses address your proposed adjustment to 2014 AMRP plant additions?

A. Yes. Mr. Hengtgen claims that I did not calculate the adjustment in my direct testimony properly because I make my "derivative adjustments to depreciation expense and the balances of accumulated depreciation and ADIT by using ratios and percentage relationships." NS-PGL Ex. 22.0 at 11:251-253. Ms. Moy also makes reference to Mr. Hengtgen's criticisms in her rebuttal testimony but does not present any additional criticisms herself. NS-PGL Ex. 21.0 at 13:261-274.

Q. Does Mr. Hengtgen offer any relevant criticisms of your methods in his rebuttal testimony?

A. No. Mr. Hengtgen has not asserted any bias in my methods, nor has he cited any under or over-statement of any of my derivative adjustments to depreciation expense, accumulated depreciation, or ADIT. As the adjustment to 2014 AMRP plant additions entails an adjustment to forecasts, it necessarily requires judgment and estimates. The question is not whether the derivative adjustments are perfect, but rather whether they are reasonable. I believe that the derivative adjustments were reasonably quantified based on the information available at the time, and Mr. Hengtgen has not provided any evidence that they are not. In any event, the adjustment I am now presenting in this rebuttal testimony has been simplified and does not employ the ratios and percentages that Mr. Hengtgen found to be so objectionable. For example, I now calculate the depreciate adjustments using the applicable depreciation rates, as Mr. Hengtgen states is appropriate. I have also prorated the adjustment to the accrual of ADIT in 2015, which addresses the "particular concern" expressed by Mr. Hengtgen on that matter.

Q. Does Ms. Egelhoff agree with to your testimony that your proposed adjustment to 2014 AMRP plant additions poses little risk, if any, to Peoples Gas?

A. No. She disagrees and states that "it is in the best interest of the customers and Peoples Gas to estimate the 2014 QIP related additions that will be included in the revenue requirement set in this proceeding as accurately as possible." NS-PGL Ex. 29.0, at 26:555-557.

Q. Do you have a response?

A. Yes. I agree that the 2014 QIP related additions that will be included in the revenue requirement set in this proceeding should be estimated as accurately as possible. That is the intent of the adjustment that I proposed above.

Ms. Egelhoff also presents an "AdjNetQIP" in Rider QIP that "could be a negative value (if the actual 2014 QIP amounts are less than the QIP related amounts approved in rate base) or a positive value (if the actual 2014 QIP amounts are greater than the QIP related amounts approved in rate base)" in her rebuttal testimony. She goes on to explain that "if AdjNetQIP is negative, the Rider QIP S% in 2015 would be negative until the QIP placed in service in 2015 equals the absolute value of the AdjNetQIP. Thus, customers are protected if the QIP amount in rate base is overstated." NS-PGL Ex. 29.0, at 25:540-546.

The "AdjNetQIP" described by Ms. Egelhoff appears to address the problem of the potential for over-recovery if the actual 2014 additions are less than the Peoples Gas forecast (without any risk of under-recovery if the actual 2014 additions are greater than the forecast) identified in my direct testimony. Nevertheless, I am continuing to propose an adjustment to the forecast of 2014 AMRP plant additions in the spirit of "estimating the 2014 QIP related additions that will be included in the revenue requirement set in this proceeding as accurately as possible."

2. Cost of Removal

Q. Did the Companies respond to your proposed adjustment to the Peoples Gas depreciation reserve related to the 2014 and 2015 forecasts of expenditures to remove and retire plant in service?

A. Yes. Mr. Lazzaro presented rebuttal testimony regarding the cost of removal for non-QIP projects in 2014 to date. NS-PGL Ex. 23.0 at 5:108-6:117.

Q. Are you modifying the proposed adjustment in your testimony based on Mr. Lazzaro's rebuttal testimony?

A. Yes. The cost of removal for non-QIP projects in 2014 through June appears to be consistent with Peoples Gas' forecasted cost of removal for non-QIP projects in 2014 and 2015. Therefore, I am no longer proposing to adjust Peoples Gas' forecasts of the cost of removal for non-QIP projects in 2014 and 2015.

3. Retirement Benefits - Net

Q. Have you updated your adjustment to the Retirement Benefits – Net based on the rebuttal testimony of Ms. Hans?

A. Yes. My summary of adjustments to rate base in this rebuttal testimony reflects the updates addressed in the Companies' rebuttal testimony. My adjustments are based on the average 2015 test year balances.

4. ADIT-NOL

Q. Did the Companies respond to your proposed adjustment to modify the deferred tax asset related to net operating loss ("NOL") carry-forwards?

A. Yes. Mr. Stabile criticized the methods that I used in my direct testimony to calculate my adjustment. NS-PGL Ex. 25.0 at 5:99-9:178. However, he also provided an update to the forecasted utilization of the available NOLs in 2014. Based on this update, the Companies are now projecting zero balances for the NOL deferred tax assets in the 2015 test year. *Id.* at 4:72-74, 5:95-97. As the Companies are now reflecting a zero balance for NOLs in the 2015 test year, the adjustments that I proposed in my direct testimony are no longer relevant, and I have not reflected any such adjustments in my calculation of the Companies' rate bases in this rebuttal testimony.

B. OPERATING EXPENSES

1. Test Year Employees

Q. Did the Companies respond to your proposal to reduce the NS and PGL forecasts of the number of employees in the 2015 test year?

A. Yes. Mr. Kinzle responded to my proposed reduction to the NS 2015 forecasted employee level, and Mr. Lazzaro responded to my proposed reduction to the PGL 2015 forecasted employee level.

Q. Does Mr. Kinzle agree with your proposed reduction to the NS 2015 forecasted employee level?

A. No. He states that North Shore intends to hire additional people in 2014 and 2015 and that the intent to hire these additional employees renders my proposed adjustment moot. NS-PGL Ex. 32.0 at 3:52-4:76.

Q. Has he established that your proposed adjustment is inappropriate?

A. No. I do not dispute that North Shore will he hiring new employees from time to time. At the same time, other employees will be retiring or leaving for other reasons. My proposed adjustment reflects a 2015 test year employee level of 166. Based on the response to Data Request NS AG 16.06, the actual number of North Shore employees in June and July of 2014 was 164. This is actually lower than the number of employees in the earlier months of 2014 and two fewer than the number of employees than I reflected in my adjustment. Thus, not only is the North Shore employee complement not showing any growth, but the latest number of employees has actually declined from earlier levels. If anything, the adjustment that I am proposing to the North Shore forecast of 2015 employees is conservative.

Q. Does Mr. Lazzaro agree with your proposed reduction to the NS 2015 forecasted employee level?

A. No. Similar to Mr. Kinzle, he states that Peoples Gas has taken measures to fill remaining open positions and that these measures render my proposed adjustment moot. NS-PGL Ex. 23.0 at 9:181-11:227.

Q. Has Mr. Lazzaro established that your proposed adjustment is inappropriate?

A. No. Again, I do not dispute that Peoples Gas will he hiring new employees from time to time. However, as with North Shore, other employees will be simultaneously retiring or leaving for other reasons. For example, Mr. Lazzaro notes that Peoples Gas hired 21 utility workers in April 2014. NS-PGL Ex. 23.0 at 9:198. However, the number of Peoples Gas employees decreased from 1,304 employees in March 2014 to 1,298 employees in April 2014 and then to 1,297 employees in May 2014 (response to Data Request PGL AG 16.09).

Q. Are you updating your proposed adjustment to the Peoples Gas forecasted test year employee complement?

A. Yes. Based on the Companies' response to Data Request PGL AG 16.09, there were 1,323 Peoples Gas employees in June 2014 and 1,315 Peoples Gas employees in July 2014. The average number of employees for these months was 1,319. I recommend that the PGL 2015 test-year payroll expense be adjusted to reflect 1,319 full time equivalent employees. My proposed adjustment to the PGL test-year employee complement reduces the forecasted test-year operation and maintenance expense by $1,904,000 and related payroll taxes by $129,000 (Schedule DJE PGL C-1).

2. Medical Benefits

Q. Did the Companies respond to your proposed adjustments to forecasted test year medical benefits?

A. Yes. Ms. Hans responded to my proposed adjustments to forecasted test year medical benefits. She offers several criticisms of my proposed adjustments, but offers no substantive justification for the magnitude of the increases being forecasted by the Companies, other than to say that the forecasts are based on estimates from the Companies' actuaries. NS-PGL Ex. 26.0 at 11:233-236. As I noted in my direct testimony, North Shore is forecasting an increase in medical benefits of 52% from 2013 to 2015, Peoples Gas is forecasting an increase of 43% over that two year period, and a 31% increase is forecasted for their affiliate, Integrys Business Services ("IBS"), in those two years. AG Ex. 1.0 at 18:389, 19:427, 28:612. Ms. Hans offers no explanation of any factors or trends that could reasonably account for increases of those magnitudes. Ms. Hans describes the process for calculating medical benefits expenses (*id.* at 11:237-243), but she does not explain why the excessive increases should be incorporated into the determination of test year medical benefits expenses

The only objective criticism of my proposed adjustment that Ms. Hans offers is that I have not taken into account employee increases since 2013 *Id.* at 11:244-12:250.

Q. Have you modified your proposed adjustments to forecasted test year medical benefits?

A. Yes. I have modified my adjustments to incorporate employee increase from 2013 to 2014 for Peoples Gas on my Schedule DJE PGL C-2, and I have also modified my adjustment to IBS medical benefits charged to Peoples Gas on my Schedule DJE PGL C-3. As I explained above, there has been no increase in the North Shore employee complement since 2013, and, therefore, no modification of my proposed adjustment to the North Shore test-year medical benefits expense is necessary. Further, even though there has been a slight increase in the number of IBS employees in 2014 over 2013, there has been no increase in the IBS labor expense allocated to North Shore in 2014. As benefits expense should follow the labor expense, I am not reflecting any increase in IBS medical benefits charged to North Shore.

On my Schedule DJE PGL C-2, I have adjusted the projected increase in Peoples Gas benefits to reflect an increase of the employee complement of 1.8% in 2014 over the employee complement in 2013. On my Schedule DJE PGL C-3, I have adjusted the projected increase in IBS medical benefits charged to Peoples Gas to reflect an increase of 1.4% above the wage rate related increase in labor charged from IBS to Peoples Gas, as described below.

Q. Ms. Hans proposes that the employee medical benefit costs be updated for the 2015 test year using the actuarial estimates when they are available. Is this reasonable?

A. It is reasonable if the estimates are reasonable. However, if the actuarial estimates continue to forecast excessive increases from the actual medical benefits expenses in

2013, those actuarial estimates should not be automatically accepted, and the Companies should be required to provide adequate justification for the magnitude of the increases being forecasted. Until the Companies present a reasonable updated actuarial forecast, the test-year medical benefits costs should be reduced.

3. IBS O&M Cross-Charges

Q. Do the Companies agree with your proposed adjustments to IBS O&M cross charges?

A. No. Ms. Kupsh responds to my proposed adjustments to IBS O&M cross charges other than incentive compensation. She disagrees with the adjustments that I proposed in my direct testimony. NS-PGL Ex. 27.0 at 3-7. Ms. Cleary responds to my testimony on incentive compensation cross charged from IBS to North Shore and Peoples Gas. Although she does not agree with my proposed adjustments to incentive compensation, she does not contest them, in acknowledgement of how similar costs have been treated by the Commission in recent cases. NS-PGL Ex. 24.0. As the Companies have incorporated adjustments to incentive compensation into the determination of the revenue requirements in their rebuttal testimony, I am not reflecting any adjustments to their position on this issue in my rebuttal testimony

a. Labor and Benefits Expenses

Q. Why does Ms. Kupsh disagree with your proposed adjustments to IBS cross charged labor expenses?

A. She cites three reasons why she disagrees with my proposed adjustments. First, she states that I do not allow for increased services provided to Peoples Gas and North Shore from IBS. Second, she states that I have not considered increased full time equivalent employees ("FTEs") at IBS. Third, she states that I have not considered shifts in the allocation percentages based on utility inputs. *Id.* at 3:52-4:75.

Q. Are these valid reasons to reject your proposed adjustments to IBS cross charged labor expenses?

A. No. I agree that I did not explicitly address each if those factors in my direct testimony. However, I did look at the *actual* increases in IBS cross charged labor from 2012 to 2013 and the IBS cross charged labor in the available months in 2014 compared to the corresponding period in 2013. To the extent that the factors cited by Ms. Kupsh actually affected the IBS cross-charged labor expenses, the effects of those factors are implicitly included in the actual expenses in 2013 and 2014 to date. Ms. Kupsh does not explain why actual increases in IBS cross charged labor expenses have so far been significantly less than the increases forecasted by the Companies.

As I noted in my direct testimony, the cross-charged labor expense to North Shore in the first four months of 2014 was actually less than the expense in the corresponding period in 2013, and the cross-charged labor expense to Peoples Gas increased in the first four months of 2014 over the corresponding period in 2013, but at a lower rate than the increase forecasted. AG Ex. 1.0 at 22:478-480, 23:511-514. Based on the response to Data Request NS AG 16.04, the cross-charged labor expense to North Shore in the first six months of 2014 was still less than the expense in the corresponding period in 2013. The cross-charged labor expense to Peoples Gas in the first six months of 2014 was 5.19% greater than the expense in the corresponding period in 2013, only 1.4% more than the increase related to changes in wage rates. Regardless of the underlying reasons for the increases in cross charged labor being forecasted by the Companies, those increases are not taking place.

Q. Have you modified your either of your proposed adjustments to IBS cross charged labor?

A. Yes. As the actual increase in cross-charged labor expense to Peoples Gas in the first six months of 2014 was slightly greater than the increase related solely to wage rate changes, I am now using the actual six-month increase of 5.19% to project the cross-charged labor expense for 2014 and 2015. I am now proposing a reduction of $3,851,000 to labor cross changed from IBS to Peoples Gas. As the cross-charged labor expense to North Shore in the first six months of 2014 was less than the expense in the corresponding period in 2013, I am not modifying my proposed adjustment to cross-charged labor expense to North Shore.

Q. Why does Ms. Kupsh disagree with your proposed adjustments to IBS cross-charged benefits expenses?

A. She explains that the 2013 actual allocation percentages and the forecasted 2015 allocation percentages that I relied on in my direct testimony to quantify my proposed adjustments were not stated on comparable bases. Using comparable bases, the actual allocation percentage for North Shore in 2013 would be 6.2%, rather than 5.7%, and the actual allocation percentage for Peoples Gas in 2013 would be 37.4%, rather than 34.1%. *Id.* at 4:80-5:103.

Q. Is this a valid criticism?

A. Yes. The actual percentage allocation factor in 2013 should be calculated on a basis consistent with the calculation of the allocation factor for the 2015 test year. I have modified my calculation of the adjustment to the 2015 IBS cross-charged benefits accordingly.

b. Postage Expense

Q. Why does Ms. Kupsh disagree with your proposed adjustments to postage expense?

A. She claims that I have not allowed for increases in volume, such as increases related to Integrys Customer Experience ("ICE") related volume. *Id.* at 5:104-6:111.

Q. Do you have a response?

A. Yes. As I noted in my direct testimony, the forecasted 2015 postage expense for NS represents an increase of 38% over the actual postage expense of $648,000 in 2013, and the forecasted 2015 postage expense for PGL represents an increase of 20% over the actual postage expense of $4,170,000 in 2013. AG Ex. 1.0 at 31:682-686. Ms. Kupsh cites factors that could potentially increase postage in volume, but she does not show how such increases in volume would lead to the magnitude of increases reflected by the Companies in their forecasts of 2015 test-year postage expenses. In effect, Ms. Kupsh appears to be claiming that the projected increases are reasonable because that is what the Companies forecasted. Unless the Companies can better detail and document the forecasted increases in postage expenses, I continue to believe that my proposed adjustments are reasonable.

c. Legal Expense

Q. Why does Ms. Kupsh disagree with your proposed adjustments to North Shore legal expenses?

A. She states that the legal services budgets are based on consultation between the business team and the legal department and that the 2015 budget is based upon assumptions regarding the expected demands and requirements of North Shore for legal services, as well as reasonable forecasts of the costs of those services. NS-PGL Ex. 27.0 at 6:112-120.

Q. Is this adequate justification for North Shore's forecast of the 2015 test year legal expense cross-charged from IBS?

A. No. This is a no more than a description of the process that is used to forecast legal expenses. The forecast of 2015 test year legal expenses represents an increase of 61% over the actual legal expense of $383,000 in 2013. Ms. Kupsh offers no explanation of the factors that could even potentially cause an increase of this magnitude. The forecast of North Shore's cross charged legal expenses from IBS should be modified. The Commission should adopt my proposed adjustment outlined in my direct testimony (AG Ex. 1.0 at 32:712-715) to use an average of actual legal expense for 2012 and 2013.

d. Return on Assets ("ROA") and Depreciation

Q. What is Ms. Kupsh's criticism of your proposed adjustment to forecasted 2015 ROA and Depreciation related to the ICE program that will be cross-charged from IBS to NS and PGL?

A. She claims my calculations are inaccurate and inappropriate.

Q. Do you have a response?

A. Yes. Ms. Kupsh claims that my calculations are "inaccurate" (NS-PGL Ex. 27.0 at 6:127), but she does not cite any errors or inconsistencies in my calculations. I understand that Ms. Kupsh disagrees with my proposed adjustments, but that does not mean that my calculations are erroneous.

Ms. Kupsh asserts that my proposed adjustments are inaccurate because they ignore forecasted expenditures and plant- in-service activity. *Id.* at 6:128. In fact, to the extent expenditures and plant in service activity have actually affected the cross charges for ROA and depreciation on the ICE project, such factors are implicitly incorporated into the adjustments that I am proposing. The Companies are forecasting substantial increase in the ROA and depreciation on the ICE project, but so far, based on the actual experience in 2014, there is little evidence that such increases are actually taking place. AG Ex. 1.0 at 33:727-737. In my opinion, this actual experience should not be ignored.

The Companies have now provided updates of the actual ROA and depreciation on the ICE project in 2014 through June (response to Data Request AG 16.13), and these updates show little change in the rate of expense from the first four months of 2014. Based on the actual experience in the first half of 2014, the annualized ICE ROA and depreciation from IBS to North Shore is $124,000, and the annualized ICE ROA and depreciation expense from IBS to Peoples Gas is $652,000. This compares to forecasted expenses of $1,378,000 to North Shore and $7,263,000 to Peoples Gas for the 2015 test year.

Ms. Kupsh claims that the only accurate measures for the ICE ROA and depreciation expenses are the Companies' forecasted 2015 test-year expenses. NS-PGL Ex. 27.0 at 7:133-134. However, the actual experience does not provide any indication that the actual level of expenses is increasing to anything like the level of expenses forecasted by the Companies. Unless the Companies can come up with some better explanation than that the only relevant reality is their forecasts, then the ICE ROA and depreciation expenses included in test year operation and maintenance expense should be modified.

Q. Have you updated your proposed adjustments to ICE ROA and depreciation expenses?

A. Yes. I have updated my adjustments based on the actual expenses for the six months ended June 30, 2014. On Schedule DJE NS C-4, I have now calculated a reduction of $1,254,000 to 2015 test-year ICE depreciation/ROA allocated from IBS to NS. On Schedule DJE PGL C-4, I have calculated a reduction of $6,611,000 to 2015 test-year ICE depreciation/ROA allocated from IBS to PGL. I would note that the updates based on additional information in 2014 do not result in significantly different annualized levels of expenses for the adjustments proposed in my direct testimony.

e. Other Non-Labor ICE Expenses

Q. Does Ms. Kupsh offer a similar criticism of your proposed adjustment to forecasted 2015 other non-labor ICE expenses that will be cross charged from IBS to NS and PGL?

A. Yes. Again, she claims my calculations are inaccurate and inappropriate. *Id.* at 7:141-142.

Q. And do you have a similar response?

A. Yes. Again, Ms. Kupsh does not cite any errors or inconsistencies in my calculations, but instead claims that I ignore forecasted operation and maintenance expenses for ICE. *Id.* I have not ignored the forecasts of operation and maintenance expenses for ICE. Rather, it is my position that other non-labor ICE expenses are not increasing as forecasted. The Companies are forecasting substantial increases in the non-labor ICE expenses, but once again there is little evidence that such increases are actually taking place. As with the ROA and depreciation on the ICE project, I believe that this actual experience should not be completely ignored.

The Companies have now provided updates of the actual expenses in 2014 through June (response to Data Request AG 16.13). These updates show little change in the rate of expense from the first four months of 2014. Based on the actual experience in the first half of 2014, the annualized non-labor ICE expenses from IBS to North Shore is $252,000, and the annualized non-labor ICE expenses from IBS to Peoples Gas is $1,352,000. This compares to forecasted expenses of $1,504,000 to North Shore and $9,058,000 to Peoples Gas for the 2015 test year.

Ms. Kupsh claims that the only accurate measures for the non-labor ICE expenses are the Companies' forecasted 2015 test year expenses. *Id.* at 7:148-149. However, the actual experience does not provide any indication that the actual level of expenses is increasing to anything like the level of expenses forecasted by the Companies. Unless the Companies can come up with some better explanation than that the test-year expenses will be whatever they forecast they will be, then the other non-labor ICE expenses included in test year operation and maintenance expense should be modified.

Q. Have you updated your proposed adjustments to the non-labor ICE?

A. Yes. I have updated my adjustments based on the actual expenses for the six months ended June 30, 2014. On Schedule DJE NS C-4, I have now calculated a reduction of $1,252,000 to 2015 test-year non-labor ICE expenses allocated from IBS to NS. On Schedule DJE PGL C-4, I have calculated a reduction of $7,706,000 to 2015 test-year ICE depreciation/ROA allocated from IBS to PGL. Again, it should be noted that the updates based on additional information in 2014 do not result in significantly different annualized levels of expenses from those presented in my direct testimony.

Q. Are there any other reasons why the Companies' forecasted increases in ROA/depreciation and other non-labor ICE expenses might be considered to be speculative?

A. Yes. As I noted in my direct testimony, on June 23, 2014, the acquisition of Integrys Energy Group, Inc. ("Integrys") – the parent of North Shore and Peoples Gas - by Wisconsin Energy Corp. was announced. That announcement made reference to "operational and financial benefits" that are "clear, achievable and compelling" and states that the transaction will be "accretive to Wisconsin Energy's earnings per share in first full calendar year after closing," with anticipated closing for the merger in the summer of 2015. In his rebuttal testimony, Mr. Derricks did not dispute the potential for "operational and financial benefits" but, rather, cites uncertainties regarding the closing of the transaction. NS-PGL Ex. 17.0 at 10:163-172.

I agree that it is not 100% absolutely certain the acquisition of Integrys by Wisconsin Energy Corp. will close exactly as planned. However, based on experience, I believe it is more likely than not that the acquisition will take place. Assuming that the acquisition does close, it would seem that the increased costs associated with the ICE project would be a likely target for the "operational and financial benefits" referenced in the announcement of the acquisition, in that the savings could be achieved by simply avoiding increases in expenses rather than having to eliminate expenses that are already being incurred. The increases associated with the ICE ROA/depreciation and other non-labor expenses are by no means certain to the extent that they should be incorporated into 2015 test year operation and maintenance expenses.

IV. SUMMARY

Q. Based on the updates in your rebuttal testimony, what revenue deficiencies or excesses have you now calculated?

A. I have calculated jurisdictional rate base of $219,789,000 and pro forma jurisdictional operating income under present rates of $14,478,000 for North Shore. Based on Staff's recommended rate of return of 6.32% as shown on ICC Staff Exhibit 3.0, Schedule 3.01, North Shore presently has an operating income deficiency of $585,000, which translates into a revenue excess of $981,000 under present rates (Schedule DJE NS A).

I have calculated jurisdictional rate base of $1,675,542,000 and pro forma jurisdictional operating income under present rates of $82,948,000 for Peoples Gas. Based on Staff's recommended rate of return of 6.55% as shown on ICC Staff Exhibit 3.0, Schedule 3.01, Peoples Gas presently has an operating income deficiency of $26,743,000, which translates into a revenue deficiency of $45,522,000 under present rates (Schedule DJE PGL A).

My revenue requirement calculations do not take any explicit account of the "operational and financial benefits" that may result from the acquisition of Integrys by Wisconsin Energy Corp. As I noted above, it would seem that the substantial increases to expenses associated with the ICE ROA/depreciation and other non-labor

ICE expenses would be a likely target for realization of such "operational and financial benefits" because these benefits could be achieved by avoiding increases in expenses rather than having to eliminate expenses that are already being incurred. More generally, the other adjustments to expenses that I have addressed above also relate to mitigation of expense increases being forecasted by the Companies. Given that mergers and acquisitions frequently result in decreases to expenses, the expense increases being forecasted by the Companies seem especially speculative in the circumstances, as the merger should enable the Companies to, at a minimum, avoid such increases. It is also well within the realm of reason that the operational and financial benefits could extend well beyond the avoidance of expense increases and result in decreases to operating expenses presently being incurred.

In my direct testimony, I noted that the merger announcement of June 23, 2014 described the "operational and financial benefits" as "clear, achievable and compelling," and I stated that the Companies should describe and quantify the expected operational and financial benefits of the proposed merger. Rather than comply with this request, the Companies only cite uncertainties regarding the closing of the proposed transaction. NS-PGL Ex. 17.0, at 10:163-172.

The merger is forecasted to close in the summer of 2015. The inability or unwillingness of the Companies to quantify the operational and financial benefits calls into question the reliability of the forecasted costs for 2015, the test year in this case and the first year that the rates established in this case will be in effect. It is entirely possible that the merger will generate cost savings well beyond the mitigation of the expense increases that I have addressed. In effect, the Companies are asking the Commission to base rates on costs that may not comport with the post-merger reality. Given the uncertain effects of the merger, the Commission should question whether any rate changes are appropriate at this time.

Q. Does this conclude your rebuttal testimony?

A. Yes.